



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

August 19, 2004

S. 2486

Veterans' Benefits Improvements Act of 2004

*As ordered reported by the Senate Committee on Veterans' Affairs
on July 20, 2004*

SUMMARY

S. 2486 would make changes to several veterans programs, primarily housing and readjustment benefits. CBO estimates that enacting this legislation would decrease direct spending for veterans programs by \$27 million over the 2005-2009 period and by \$9 million over the 2005-2014 period. In addition, CBO estimates that discretionary spending resulting from S. 2486 would be less than \$100,000 a year over the 2005-2009 period, assuming appropriation of the necessary amounts.

S. 2486 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 2486 over the 2005-2009 period is shown in Table 1. The costs of this legislation fall within budget function 700 (veterans benefits and services).

BASIS OF ESTIMATE

This estimate assumes that the bill will be enacted by October 1, 2004. Almost all of the budgetary impact of the bill would be in the form of direct spending for veterans' housing and readjustment benefits. Table 2 summarizes those effects, and the individual provisions that would affect direct spending are described below. In total, CBO estimates that enacting this legislation would decrease direct spending by \$27 million over the 2005-2009 period and by \$9 million over the 2005-2014 period.

TABLE 1. ESTIMATED BUDGETARY IMPACT OF S. 2486

	By Fiscal Year, in Millions of Dollars				
	2005	2006	2007	2008	2009
CHANGES IN DIRECT SPENDING					
Estimated Budget Authority	-38	-28	*	18	22
Estimated Outlays	-38	-28	*	18	22

NOTES: Estimated changes in discretionary spending are less than \$100,000 a year.
* = less than \$500,000.

Direct Spending—Housing

Sections 101 through 104 would affect direct spending for veterans' housing programs. Together, CBO estimates that these provisions would lower direct spending by \$39 million in 2005, \$184 million over the 2005-2009 period, and \$259 million over the 2005-2014 period. In preparing this estimate, CBO accounted for the interactions between individual provisions. Costs or savings for those provisions, estimated as if they were enacted alone, are described below, along with the effect of interactions between the provisions.

Increase and Index VA Home Loan Guaranty. Section 101 would increase the maximum loan guarantee amount on Department of Veterans Affairs (VA) home loans by indexing this amount to the Freddie Mac conforming loan limit for single-family homes, which is adjusted annually to reflect home prices. Under current law, the maximum loan guaranty is \$60,000, which effectively creates a maximum loan amount of \$240,000. (For large loan amounts, VA can guarantee no more than 25 percent of the loan amount.) The provision would raise the maximum loan guarantee amount to 25 percent of the Freddie Mac conforming loan limit (\$333,700 in 2004).

CBO estimates that this provision would lower direct spending on the veterans' housing program by \$208 million over the 2005-2009 period and \$288 million over the 2005-2014 period. These savings are the net effect of three individual program effects (two with savings and one with costs), as explained below.

TABLE 2. ESTIMATED CHANGES IN DIRECT SPENDING UNDER S. 2486

	Outlays by Fiscal Year, in Millions of Dollars										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
HOUSING ^a											
Spending Under Current Law	-2,036	-144	-140	-144	-149	-153	-152	-155	96	98	165
Proposed Changes	0	-39	-38	-35	-35	-36	-41	-42	*	1	8
Spending Under S. 2486	-2,036	-183	-178	-179	-184	-189	-193	-197	96	99	173
VETERANS' READJUSTMENT BENEFITS											
Spending Under Current Law	2,665	2,852	3,008	3,166	3,315	3,458	3,590	3,737	3,853	3,974	4,098
Proposed Changes	0	1	10	35	53	58	52	26	5	5	5
Spending Under S. 2486	2,665	2,853	3,018	3,201	3,368	3,516	3,642	3,763	3,858	3,979	4,103
Total Proposed Changes ^a	0	-38	-28	*	18	22	11	-16	5	6	13

NOTES: Numbers may not add to totals because of rounding.

* = less than \$500,000.

a. Five- and 10-year costs in the text differ slightly from a sum of the annual costs shown here because of rounding.

Based on information from VA and previous increases in the loan guaranty amount, CBO estimates that the bill would result in 11,000 new guaranteed loans a year over the 2005-2014 period. In addition, roughly 4,000 guaranteed loans each year would now be made with higher loan amounts—these would not be new borrowers, but veterans who would no longer need a downpayment (or as large a downpayment) to qualify for the VA loan guarantee. CBO and VA estimate that the VA loan guarantees currently have a negative subsidy rate of about -0.3 percent, reflecting relatively low default rates and up-front fees.

Because of that negative subsidy rate, CBO estimates that the added loans and higher loan amounts would lower direct spending on guaranteed loans by an average of \$42 million a year over the 2005-2011 period. Savings would end after 2011 because, under current law, certain loan fees expire in 2012, resulting in higher subsidy rates beginning in that year. Consequently, the increase in the volume of guaranteed loans under S. 2486 would raise direct spending by \$10 million over the 2012-2014 period.

Second, CBO expects some of those 15,000 loans will become delinquent and go to foreclosure. When a guaranteed loan goes into foreclosure, VA often acquires the property and issues a new direct loan (called a vendee loan) when the property is sold. Because the

vendee loan program also has a negative subsidy rate, CBO estimates that the added vendee loans would lower direct spending by less than \$500,000 in 2005 and by \$3 million in 2014.

Finally, VA sells most vendee loans on the secondary mortgage market and guarantees their timely repayment. Based on information from VA, CBO estimates the subsidy cost of such loan guarantees would be less than \$500,000 through 2007 and would eventually reach \$4 million in 2014.

Guarantees of Adjustable Rate Mortgages (ARMs). Section 102 would reinstate VA's program of guarantees for adjustable rate mortgages through 2011. Under that program, interest rates on adjustable rate mortgages guaranteed by VA may change annually. Section 103 would extend through 2011 VA's current pilot program of guarantees for hybrid ARMs, which carry an initial interest rate that is fixed for at least three years and then is subject to annual adjustments. That program is scheduled to expire at the end of 2005.

CBO expects that most veterans would prefer a hybrid ARM. Based on information from VA and experience with the current pilot program, we estimate that about 30,000 hybrid ARMs would be guaranteed each year and that these loans would be 5 percent larger and 10 percent more likely to default than fixed-rate mortgages. (CBO estimates that fixed-rate mortgages guaranteed by VA have a default rate of 7.1 percent and that the hybrid ARMs would have a default rate of 7.8 percent.) Under current law, most of those borrowers would receive VA guarantees for fixed-rate mortgages.

We also expect that about 1,000 ARMs would be guaranteed each year and that those loans would be 20 percent larger and 50 percent more likely to enter into default than fixed-rate mortgages; the projected default rate on those loans is 10.6 percent.

CBO estimates that enacting these provisions would increase direct spending by \$45 million over the 2005-2011 period. That sum represents the additional subsidy cost, as defined by the Federal Credit Reform Act, of guaranteeing the two kinds of ARMs. (That cost is the net present value of expected payments by the government to cover defaults and delinquencies, as well as other necessary payments, net of expected receipts to the government from any loan fees, penalties, and recoveries.)

Effect of Interactions Between Housing Provisions. The estimated cost of enacting sections 102 and 103 and the estimated savings from enacting section 101 are both increased by an interactive effect. CBO estimates that the net effect of this interaction would be additional savings of \$16 million over the 2005-2011 period.

Loan Fees from Veterans Eligible for Compensation. Section 104 would prohibit VA from charging loan fees for veterans who have been rated eligible for compensation through a pre-discharge examination. Under current law, a veteran must be receiving compensation

in order to have the fees waived. Based on information from VA, CBO estimates that the enactment of this section would affect very few individuals and would have an insignificant effect on direct spending.

Direct Spending—Veterans’ Readjustment Benefits

S. 2486 contains several provisions that would enhance the education benefits available to reservists, veterans, and the spouses and survivors of certain veterans. CBO estimates that enacting these sections would increase direct spending for veterans’ readjustment benefits by about \$1 million in 2005, \$157 million over the 2005-2009 period, and \$250 million over the 2005-2014 period (see Table 3). The cost for each individual provision is described below.

TABLE 3. ESTIMATED CHANGES IN DIRECT SPENDING FOR VETERANS’ READJUSTMENT BENEFITS UNDER S. 2486

Description of Provisions	Outlays by Fiscal Year, in Millions of Dollars									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Expanded Education Assistance for Certain Reservists	-1	6	31	48	53	47	21	0	0	0
Exams for College Admission and for Course Credit	1	3	3	4	4	4	4	4	4	4
Extension of Eligibility Period	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>
Total Changes in Veterans’ Readjustment Benefits	1	10	35	53	58	52	26	5	5	5

Expanded Education Assistance for Certain Reservists. Montgomery GI Bill (MGIB) education benefits are available to most active-duty servicemembers who agree to have \$1,200 withheld from their pay and who serve three years of continuous active duty. Reduced MGIB benefits are available to servicemembers who make the same contribution and serve two years. Under current law, reservists who serve two continuous years of active duty are also eligible for the reduced MGIB benefit, currently \$800 dollars a month for 36 months. Section 202 would extend eligibility for the two-year MGIB benefit to reservists who, after September 11, 2001, and before June 30, 2008, complete a total of two, noncontinuous years of active duty in any five-year period. Reservists who choose to participate in the MGIB program would have one year after completion of their two qualifying years of service to remit the \$1,200 contribution.

Based on information from the Department of Defense (DoD), CBO estimates that more than 25,000 reservists would accumulate two noncontinuous years of active duty and make the \$1,200 payments in the time period described above. Based on current usage rates, CBO assumes that 80 percent of those who make the \$1,200 payment would use the MGIB benefit, resulting in a few hundred new trainees in 2005, and an average of about 7,300 additional trainees a year over the 2006-2011 period. CBO also assumes that these new trainees would use this benefit to the same extent as current trainees, with an average benefit of about \$4,800 in 2005, increasing in subsequent years by a cost-of-living adjustment. After considering the \$1,200 contributions, CBO estimates that enactment of section 202 would decrease direct spending for readjustment benefits by \$1 million in 2005, and increase direct spending by about \$140 million over the 2005-2009 period, and \$205 million over the 2005-2011 period.

Exams for College Admission and for Course Credit. Section 204 would allow those veterans, survivors, and reservists who are eligible for veterans' education benefits to use those benefits to pay for tests given nationally for college admission and for course credit. Based on information from VA, CBO estimates that in 2005 about 190,000 veterans, reservists, and survivors and dependents will begin a course of study at a college or university. For several reasons, CBO believes that only about 20 percent of those students would use the proposed benefit. First, the Defense Activity for Non-Traditional Education Support (DANTES), currently offers most admissions and many for-credit exams at no cost to active-duty and reserve servicemembers. Thus, members beginning their education within a few years of their separation from the service, or while in the reserves, are likely to take any necessary tests through DANTES at no charge. Furthermore, many veterans have taken some college-level courses while on active duty and thus are admitted to college based on their previous work and not on the results of entrance exams. Finally, close to half of the students will likely be attending two-year colleges, which do not normally require entrance exams.

Based on information from VA and DoD, CBO estimates that, in 2005, about 11,000 of these students would take one or more entrance or course-credit exams at an average cost of \$85 and would be reimbursed by VA under this provision. As the benefit becomes more widely known, CBO expects the number of students using the benefit would increase over several years to about 40,000 a year. Assuming the test fees increase with inflation to an average of about \$100 in 2014, CBO estimates enacting this proposal would increase direct spending for veterans' readjustment benefits by \$1 million in 2005, \$15 million over the 2005-2009 period, and \$35 million over the 2005-2014 period.

Extension of Eligibility Period. Under the Survivors and Dependents Education Assistance Program, spouses of veterans who are totally disabled as a result of a service-connected disability, and the unmarried, surviving spouses of servicemembers who died on active duty or of veterans who died of a service-connected disability or while totally disabled as the

result of a service-connected disability, are eligible for 36 months of education assistance, at the current rate of \$788 a month. Eligible spouses and surviving spouses have 10 years from the date the veteran is rated as totally disabled or from the date of the servicemember's or veteran's death to use the benefit. Section 203 would increase the eligibility period to 20 years for the unmarried, surviving spouses of members who died on active duty.

Based on information from VA and DoD, CBO expects that under section 203, an additional 260 spouses would use this education benefit each year. However, because the 2004-2005 academic year would have started before the assumed enactment date for S. 2486, CBO expects only about 130 additional spouses would apply for this benefit in fiscal year 2005. Assuming these trainees pursue their education at the historical rate for spouses in the survivors and dependents education program, CBO estimates they would receive an average benefit of \$4,300 in 2005. Allowing for annual cost-of-living increases in the benefit amount, CBO estimates that enactment of section 203 would increase direct spending for veterans' readjustment benefits by about \$600,000 in 2005, \$5 million over the 2005-2009 period, and \$10 million over the 2005-2014 period.

Collection of Contributions. Reservists who serve two continuous years of active duty are eligible to participate in the MGIB program. DoD reports that about 10,000 reservists have recently met this requirement. Under current law, a reservist's pay cannot be reduced to pay the required \$1,200 contribution, so reservists who wish to participate in the MGIB program are currently obliged to make direct payments. Section 201 would allow DoD to collect those contributions through reductions in basic pay as is done for active-duty members, or through other appropriate methods. Since the current method is cumbersome, CBO believes that simplifying payment of the contribution would increase the number of reservists who choose to participate in MGIB, but only slightly. The resulting increase in spending would not be significant.

Spending Subject to Appropriation

Section 302 would require the Veterans' Advisory Committee on Former Prisoners of War to submit a report in 2005, 2007, and 2009, to the Secretary of Veterans Affairs assessing the extent to which VA programs and activities are meeting the needs of former prisoners of war. Under current law, the Advisory Committee was only required to submit this report through 2003. According to information from the General Services Administration's Federal Advisory Committee Database, the cost to operate this committee is expected to total about \$100,000 in 2004. Since the committee would continue to operate and advise the Secretary absent this reporting requirement and since salaries, travel, and other expenses account for much of the cost of operating the committee, CBO estimates that implementing this provision

would cost a small fraction of that annual cost over the 2005-2009 period, assuming appropriation of the necessary amounts.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 2486 contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

PREVIOUS CBO ESTIMATES

On July 13, 2004, CBO transmitted a cost estimate for H.R. 1716, the Veterans Earn and Learn Act of 2004, as reported by the House Committee on Veterans' Affairs on June 25, 2004. Section 301 of H.R. 1716 is identical to section 101 of S. 2486, as are the estimated savings.

On May 25, 2004, CBO transmitted a cost estimate for H.R. 4345, a bill to amend title 38, United States Code, to increase the maximum amount of home loan guarantee available under the home loan guarantee program of the Department of Veterans Affairs, and for other purposes, as ordered reported by the House Committee on Veterans' Affairs on May 19, 2004. On May 18, 2004, CBO transmitted a cost estimate for H.R. 4345, as introduced on May 12, 2004. Both versions of H.R. 4345 are identical to section 101 of S. 2486, as are the estimated savings.

On April 28, 2004, CBO transmitted a cost estimate for H.R. 4065, the Veterans Housing Affordability Act of 2004, as introduced on March 30, 2004. H.R. 4065 would raise the maximum loan guarantee amount to 22.5 percent of the Freddie Mac conforming loan limit. Section 101 of S. 2486 would raise the maximum loan guarantee amount to 25 percent of the Freddie Mac conforming loan limit. Thus, the estimated savings from enacting section 101 are somewhat larger.

ESTIMATE PREPARED BY:

Federal Costs:

Housing: Sunita D'Monte

Readjustment Benefits: Sarah T. Jennings

Veterans' Outreach: Dwayne M. Wright

Impact on State, Local, and Tribal Governments: Melissa Merrell

Impact on the Private Sector: Heidi Golding

ESTIMATE APPROVED BY:

Robert A. Sunshine

Assistant Director for Budget Analysis